UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67793

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3415

ADMINISTRATIVE PROCEEDING
File No. 3-15012

In the Matter of **Scott W. Hatfield, CPA; and** **S. W. Hatfield, CPA** **Respondents.**	**DIVISION OF ENFORCEMENT'S MOTION FOR SUMMARY DISPOSITION AND BRIEF IN SUPPORT**

Pursuant to Rule 250 of the Commission's Rules of Practice ("Rules of Practice"), the Division of Enforcement ("Division") of the United States Securities and Exchange Commission ("Commission") moves for summary disposition of this action because there exists no genuine issue with regard to any material fact and the Division is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b).

I.
INTRODUCTION

The key questions in this case are:

(1) whether S.W. Hatfield, CPA's ("SWH") license to provide certified public accounting services was expired between January 31, 2010 and May 19, 2011; and

(2) whether Respondents issued audit reports for public company issuers while SWH's firm license was expired.

If so, the Division contends, Respondents violated Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder and should be ordered to cease and desist therefrom and should further be permanently barred from appearing before the Commission pursuant to Rule of Practice 102(e)(1)(i) and (iii).

In their Answer, Respondents admit that SWH's firm license was expired from January 31, 2010 until May 19, 2011. And while they deny issuing 38 audit reports while SWH's license was expired, indisputable records of Respondents' issuer clients, including registration statements and periodic reports filed with the Securities and Exchange Commission, demonstrate that they did.

II.
EVIDENCE SUPPORTING SUMMARY DISPOSITION

The Division respectfully submits the following evidence in support of its Motion:

Exhibit 1: Excerpt of Respondents' September 20, 2012 Production of Documents to the Commission: March 8, 2010 TSBPA email string

Exhibit 2: Declaration of Division Staff Accountant David R. King

Exhibit A to King. Dec:	March 28, 2010 Letter to Respondents
Exhibit B to King Dec:	April 10, 2010 Subpoena to Respondents
Exhibit C to King Dec:	April 24, 2013 Letter to Respondents
Exhibit D to King Dec:	TEXAS STATE BOARD REPORT, Texas State Board of Public Accountancy, November 2008, Volume 97 at p. 11; TEXAS STATE BOARD REPORT, Texas State Board of Public Accountancy January 2009, Vol. 101 at pp. 1, 6-7; and TEXAS STATE BOARD REPORT, Texas State Board of Public Accountancy, November 2012, Vol. 113 at p. 3
Exhibit E to King Dec:	SWH's "Report[s] of Registered Independent Certified Public Accounting Firm"

Exhibit F to King. Dec:	SWH Issuer Client Commission Filings
Exhibit G to King Dec:	Appendix of Filings Including Audit Reports Issued By SWH while License Expired January 31, 2010 to May 19, 2011
Exhibit H to King Dec:	SWH Form 2 for reporting periods April 1, 2009 – March 31, 2010 and April 1, 2010 – March 31, 2011
Exhibit I to King. Dec:	Division of Enforcement's Prejudgment Interest Calculator Report

Exhibit 3: Declaration of TSBPA Executive Director William Treacy

Exhibit A to Treacy Dec:	October 9, 2009 TSBPA Letter to Respondents
Exhibit B to Treacy Dec:	March 11, 2010 TSBPA Internal Email
Exhibit C to Treacy Dec:	March 8, 2010 TSBPA Email to Respondents
Exhibit D to Treacy Dec:	March 15, 2010 TSBPA Letter to Koepke
Exhibit E to Treacy Dec:	July 8, 2010 TSBPA Letter to Koepke
Exhibit F to Treacy Dec:	January 24, 2013 TSBPA Report of SWH Firm License Fee Payments

III.
PROCEDURAL BACKGROUND

This proceeding was instituted on September 6, 2012 pursuant to Sections 4C and 21C of the Exchange Act and Rules of Practice 102(e)(1)(i) and (iii), to determine whether Respondents should (1) be ordered to cease and desist from committing or causing violations of Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 ("Exchange Act") and, if so, whether they should be ordered to pay civil penalties and disgorge their ill-gotten gains with prejudgment interest; and (2) be censured or denied, temporarily or permanently, the privilege of appearing or practicing before the Commission. The Commission issued corrected Orders Instituting Public

Administrative Proceedings on October 17 and November 15, 2012 to address formatting errors in the document, but did not alter the Division's substantive allegations.

Respondents were properly served with the Second Corrected OIP, which they answered on December 20, 2012. The Division made its entire non-privileged investigative file available to Respondents for inspection, and Respondents inspected the file on January 15, 2013. During the parties' January 7, 2013 prehearing conference with this Court, the Division was given leave to file the instant motion for summary disposition.

IV.
STATEMENT OF UNDISPUTED FACTS

Defendants admit that SWH is a public accounting firm based in Dallas, Texas and registered with the Public Company Accounting Oversight Board ("PCAOB"). Respondents' Answer, at "Respondents" ¶ 1. Hatfield agrees that he has been a licensed certified public accountant in Texas since 1985. *Id.* at ¶ 2. Respondents do not dispute that Hatfield is SWH's sole officer, director, and accountant. *Id.*. Respondents further admit that Hatfield obtained SWH's initial license to practice as a public accounting firm from the Texas State Board of Public Accountancy ("TSBPA") in 1994, and thereafter renewed SWH's license annually through January 2009. Respondents' Answer, at "Facts," ¶ 1.

Respondents freely admit in their Answer that SWH's firm license expired on January 31, 2010 and was not renewed until May 19, 2011.[1] *Id.* at ¶ 5. Furthermore, Respondents do not deny that Hatfield knew SWH's license had expired, but instead claim that they are not required to answer this allegation and, alternatively, "lack sufficient information" to admit it. *Id.* At the very

[1] As will be shown below, TSBPA business records reflect that SWH's license was not renewed until May 25, 2011. However, the Division alleged, and Respondents admitted, that SWH's firm license was renewed on May 19, 2011. For purposes of this motion, the Division will indulge every doubt in Respondents' favor and continue to assert that SWH's firm license was successfully renewed on May 19, 2011.

least, Respondents have admitted that they knew SWH's firm license had expired no later than March 8, 2010, when SWH affiliate Ronald W. Johnson forwarded to Hatfield a TSBPA email addressing the expiration. *See* Excerpt of Respondents' September 20, 2012 Production of Documents to the Commission, March 8, 2010 TSBPA email string, attached hereto as Exhibit 1.

Respondents agree that each certified public accounting firm licensed by TSBPA that performs attest services must enroll and participate in a peer review program. *Id.* at ¶ 3. The parties agree that firms performing attest services only for issuer clients can meet this requirement through an inspection process carried out by the PCAOB. *Id.* The parties also agree that a firm that performs attest services for any non-issuer clients must also enroll in a peer review program for review of its non-public company attest work. *Id.*

V.
REMAINING MATERIAL FACTS DEFENDANTS DO NOT ADMIT BUT FOR WHICH THERE IS NO GENUINE ISSUE IN DISPUTE

A. THE SECURITIES LAWS REQUIRED RESPONDENTS TO HAVE A VALID PUBLIC ACCOUNTANCY LICENSE TO PRACTICE AS A CPA FIRM IN TEXAS.

Regulation S-X, which lays out the specific format and content for financial reports, requires audit reports to be prepared by "an independent public or certified public accountant." *See* SEC Reg. S-X at Rule 1-02(a), 17 C.F.R. § 210.1-02(a)(1). Rule 2-01 of the Regulation specifies that public accountants "are only those duly registered and in good standing" in the jurisdiction in which they reside, in this case, Texas. *Id.*, § 210.2-01.

Under the Texas Public Accountancy Act, a firm may not provide attest services or hold itself out as a certified public accounting firm unless it holds a validly issued firm license. *See* TEX. OCC. CODE § 901.351(a); TEX. ADMIN. CODE § 501.80. Attest services are defined in the Texas Public Accountancy Act to include audits. TEX. OCC. CODE § 901.002(a)(1). Furthermore,

only a license holder may perform an attest service or issue a report on a financial statement. *Id.* § 901.456.

A firm license must be renewed annually. *Id.* § 901.351(d). By statute, at least thirty days before the expiration of a license, the TSBPA provides written notice to a license holder of the impending license expiration. *Id.* § 901.404.

A licensee who has failed to pay the annual fee is not in good standing in the State of Texas and is not permitted to hold itself out as a CPA until all fees are paid. *See* Declaration of David King ("King Dec."), attached hereto as Exhibit 2, at ¶ 10 and Exhibit D.

Hence, a firm that fails to maintain its CPA license in Texas is not in good standing and, therefore, is not recognized as a public accountant under Regulation S-X of the federal securities laws. Here, not only was SWH not in good standing in Texas between January 31, 2010 and May 19, 2011, Respondents knowingly issued audit reports for multiple issuers during this time, despite their awareness that doing so violated the law.

B. RESPONDENTS WERE REPEATEDLY NOTIFIED ABOUT LICENSE EXPIRATION.

Respondents cannot dispute that they were notified, on multiple occasions, that SWH's firm license would expire, and had in fact expired due to non-payment of required fees and failure to complete required peer reviews.

By September 28, 2009, SWH was three years past-due on its obligation to complete peer review requirements. In a letter dated October 9, 2009, the TSBPA notified Respondents that SWH's CPA license for 2010 had not been issued and that SWH had failed to report its peer review results for the years 2006 – 2010. Treacy Dec., ¶ 5. No later than December 31, 2009, the TSBPA sent Respondents written notification that SWH's firm license would expire on January 31, 2010, as it was required to do by law. *See* TEX. OCC. CODE § 901.404; Treacy Dec., ¶ 6.

By no later than February 2010, Virginia Moher, an enforcement attorney for the TSBPA, was in regular contact with John Koepke, a Jackson Walker L.L.P. attorney engaged to represent Hatfield in a PCAOB investigation into his accountancy practices, regarding Respondents' licensing and peer review delinquency issues.[2] *See* Treacy Dec., ¶ 7.

In or before March 2010, the TSBPA again alerted Respondents, in a phone call with attorney Koepke, that SWH's firm license was expired, that it was three years delinquent in satisfying its peer review requirements, and that Respondents could be sanctioned for providing attest services without a valid firm license. Treacy Dec., at ¶ 8. According to the TSBPA, Respondents claimed that they did not provide attest services to non-issuer clients and, therefore, were exempt from peer review. *Id.* Based on that claim, the TSBPA sent a follow up letter to Respondents' counsel on March 15, 2010, notifying them that they were required to provide a PCAOB letter stating that all issues arising from its September 28, 2005 inspection had been "satisfactorily addressed" by SWH. *Id.*, ¶ 10.

On March 8, 2010, the TSBPA's Licensing Division notified SWH affiliate Ronald Johnston, by email, that SWH's firm license was delinquent and expired. *Id.*, ¶ 9. On the very same day, Mr. Johnson forwarded that email to Respondents. *See* Exhibit 1. In Respondents' September 20, 2012 production of documents to the Commission, they produced a document admitting their receipt of the TSBPA's email on March 8, 2010. *Id.* Hence, even if Respondents claim they were unaware SWH's license expired January 31, 2010, they have admitted that they knew of its expiration no later than March 8, 2010, yet they did not renew it until more than a year thereafter. *Id.*

[2] The TSBPA first contacted Hatfield, through Jackson Walker counsel John Koepke, in Spring 2008. Koepke first responded to the TSBPA, on Hatfield's behalf, on May 14, 2008 to report his client's efforts to address the findings reached in a separate investigation of Hatfield's accountancy practices conducted by the PCAOB. *See* Treacy Dec., ¶ 7.

On July 8, 2010, the TSBPA sent another letter to Koepke advising that SWH's firm license would be blocked and that the firm could not (a) hold itself out as a CPA firm; or (b) perform audits or attestations because its firm license was delinquent and expired. *Id.*, ¶ 12.

Finally, on May 25, 2011, the TSBPA permitted SWH to obtain a firm license after the firm paid the required fee and after determining that the PCAOB had not issued final sanctions against Respondents and that SWH did not service non-issuer clients requiring the firm to submit to peer review.[3] *Id.*, ¶ 13.

Respondents cannot reasonably dispute that they knew SWH's firm license had expired on January 31, 2010 or, at the very latest, by March 8, 2010 as they've admitted in these proceedings. Having admitted that SWH's license expired and having admitted knowledge of its expiration no later than March 8, 2010 (though the Division contends Respondents were aware well before January 31, 2010), the only remaining issue to be determined is whether Respondents provided attest services and issued reports on financial statements while SWH's firm license was expired.

C. RESPONDENTS ISSUED 38 AUDIT REPORTS FOR 21 PUBLIC COMPANY ISSUERS WHILE THEY KNEW SWH WAS UNLICENSED.

Despite repeated notices and warnings from the TSBPA, Respondents admit that they did not renew SWH's license to practice public accounting in Texas until May 19, 2011, nearly sixteen months after it expired. *See* Respondents' Answer, ¶ 5. Nevertheless, SWH issued 38 audit reports for 21 issuers while its license was expired. *See* King Dec., ¶ 11. Those issuers included SWH's audit reports in registration statements and periodic reports they filed with the Commission. *Id.*, ¶ 12.

Respondents admit to issuing audit reports while SWH's license was expired in SWH's annual reports filed with the PCAOB on Form 2. *See* King Dec., ¶ 14. In SWH's Forms 2,

[3] The Division is not satisfied that SWH does not provide attest services for non-issuer clients.

Respondents list the audit reports it issued between January 31, 2010 and May 19, 2011. *Id.* Although registered firms report the audit report date, e.g. the date the audit is substantially complete, rather than the issue date, e.g., the date the auditor authorizes the issuer to include the audit report in a filing with the Commission, Respondents' Forms 2 demonstrate that Respondents issued audit reports while SWH's license was expired. *Id.*

SWH's audit reports were included in the public filings of issuer clients who issued, offered, and sold securities while SWH's license was expired. *Id.*, ¶ 15. Five of the 21 issuer clients for whom SWH issued audit reports while its license was expired were, at that time, quoted on the Pink Sheets, as reflected in the following chart summarizing the number of days traded, the average trading volume and the low, high, and average close price per issuer during the relevant period:

Issuer	No. Days Traded	Avg. Daily Volume	Close Price		
			Low	High	Average
8888 Acquisition Corp. (EGHA); (Registration withdrawn Aug. 17, 2011)	13	261	$ 0.07	$ 3.00	$ 1.11
Eight Dragons Co. (EDRG)	26	213	$ 0.07	$ 1.70	$ 0.57
HPC Acquisitions, Inc. (HPCQ)	23	8,665	$ 0.01	$ 0.75	$ 0.15
Truewest Corp. (TRWS)	7	200	$ 0.10	$ 3.00	$ 1.39
X-Change Corp. (XCHC)	128	9,268	$ 0.20	$ 1.58	$ 0.47

Id. Another of the 21 issuer clients, SMSA Kerrville Acquisition Corp., issued securities while SWH's license was expired. *Id.*, ¶ 16. Specifically, on December 15, 2010, SMSA Kerrville issued 9.5 million shares of restricted, unregistered common stock in exchange for 100% of the outstanding common stock of another company. *Id.* Four other issuer clients of SWH – Signet

International Holdings, Inc., SMSA Crane Acquisition Corp., and SMSA Gainesville Acquisition Corp., and X-Change Corp. – issued securities while SWH's firm license was expired. *Id.*, at ¶ 17.

Respondents charged $187,222 as fees for audits conducted or completed while SWH's license was expired. *Id.*, ¶ 18.

VI.
ARGUMENT AND AUTHORITY

A. STANDARD FOR SUMMARY DISPOSITION

Rule of Practice 250(a) permits a party, with leave of the hearing officer, to move for summary disposition of any or all of the OIP's allegations. 17 C.F.R. § 201.250(a). The Administrative Law Judge may grant such a motion if there is no genuine issue of material fact and the Division is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b). *Accord, In re Renert*, Initial Decisions Rel. No. 254, 2004 § LEXIS 1579, at *3 (July 27, 2004); *In re Lorsin, Inc.*, Initial Decisions Rel. No. 250, 2004 § LEXIS 961, at *3 (May 11, 2004); *In re Crowder*, Initial Decisions Rel. No. 245, 2004 § LEXIS 205, at *4-5 (Jan. 30, 2004). As one Administrative Law Judge explained,

> By analogy to Rule 56 of the Federal Rules of Civil Procedure, a factual dispute between the parties will not defeat a motion for summary disposition unless it is both genuine and material. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986). Once the moving party has carried its burden, 'its opponent must do more than simply show that there is some metaphysical doubt as to the material facts.' *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586 (1986). The opposing party must set forth specific facts showing a genuine issue for a hearing and may not rest upon the mere allegations or denials of its pleadings. At the summary disposition stage, the hearing officer's function is not to weigh the evidence and determine the truth of the matter, but rather to determine whether there is a genuine issue for resolution at a hearing.

See Anderson, 477 U.S. at 249.*Edward Becker*, Initial Decision Rel. No. 252, 2004 § LEXIS 1135, at *5 (June 3, 2004).

Summary disposition is particularly appropriate in a case such as this, where Respondents admit many of the material facts and the plain language of their own documents establishes the essential elements of the Division's claims.

B. RESPONDENTS WILLFULLY VIOLATED SECTION 10(B) OF THE EXCHANGE ACT AND RULE 10B-5 THEREUNDER AND SHOULD BE ORDERED TO CEASE AND DESIST FROM COMMITTING OR CAUSING FUTURE VIOLATIONS OF THESE PROVISIONS.

Exchange Act Section 10(b) and Rule 10b-5(b) prohibit an issuer or individual from making misstatements or omissions of material fact in connection with the purchase or sale of a security.[4] *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(b). These provisions state that "it shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security." *Id.*

1. Materiality and Scienter under Section 10(b) and Rule 10b-5.

For liability to attach under Section 10(b) and Rule 10b-5, omissions or misstatements must be material. The test for materiality is whether there is a substantial likelihood that a reasonable investor would consider the information important to his investment decision, and would view it as

[4] The "in connection with" requirement of Section 10(b) is satisfied when a misrepresentation or omission occurs in a periodic report filed with the Commission. *See In re Ames Dep't. Stores Inc. Stock Litig.*, 991 F.2d 953, 962 (2d Cir. 1993); *In re Leslie Fay Cos, Inc., Sec. Litig.*, 871 F. Supp. 686, 699 (S.D.N.Y. 1995).

having significantly altered the total mix of available information. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

In addition to proof of materiality, violations of Section 10(b) and Rule 10b-5 require proof of scienter. *See Aaron v. SEC,* 446 U.S. 680, 695 (1980); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). The scienter requirement is also satisfied by showing that the respondent acted recklessly, defined as "an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977); *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990); *Hackbart v. Holmes*, 675 F.2d 1114, 1117 (10th Cir. 1982); *Broad v. Rockwell Int'l Corp.,* 642 F.2d 929, 961-62 (5th Cir.), *cert. denied*, 454 U.S. 965 (1981). Proof of scienter need not be direct, but may be "a matter of inference from circumstantial evidence." *Herman & Maclean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983). The mental state of a corporation is established through the mental states of its officers. *See SEC v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1088 n.3 (2d Cir. 1972).

2. Respondents' misstatements, omissions, and conduct were material.

The Commission has taken the position that inclusion of an audit report issued by a person not recognized as an accountant is a material misstatement. In *In the Matter of Ronald Effren*, et al., the Commission held that an accountant willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Exchange Act Section 10(b) when he held himself out as a CPA, audited an issuer's financial statements, and consented to inclusion of his audit report in the issuer's public filings while he was unlicensed and, therefore, not recognized by the Commission

as a certified public accountant. *See In the Matter of Ronald Effren, et al.,* 1996 SEC LEXIS 69 (January 16, 1996) (settled administrative proceeding).

Similarly, in *In the Matter of Alan S. Goldstein,* the Commission held that an accountant violated Securities Act Section 17(a) when he served as the auditor for two registered broker-dealers while his license to practice as a certified public accountant was expired due to non-payment of required fees. *In the Matter of Alan S. Goldstein,* 1994 SEC LEXIS 2787 (SEC 1994) (settled administrative proceeding).

Furthermore, in *SEC v. CoElco, Ltd.*, the Central District of California entered a permanent injunction against an accountant for violating, and aiding and abetting violations of, the antifraud provisions of the securities laws based on his issuance of audit reports, while unlicensed, that were included in an issuer's Commission filings. *SEC v. CoElco, Ltd., et al.,* Civil Action No. 86-7892 (C.D. Cal.) (October 25, 1988); 1988 SEC LEXIS 2184 (October 31, 1988).

In this case, the materiality of Respondents' decision to issue audit reports when SWH was not permitted to do so, or even to hold itself out as a CPA firm, and to omit disclosing that information to issuer clients or the public, cannot reasonably be disputed. Implicit in each of SWH's audit reports issued between January 31, 2010 and May 19, 2011 was the representation to each issuer that SWH was recognized as a CPA under the federal securities laws and qualified and permitted to issue audit reports on its clients' financial statements.

When each of the 21 separate issuers included SWH's audit reports in its Commission filings, investors in those companies were invited, and expected, to rely on the audited financials as complete, accurate, and reliable. The fact that the issuers' financial statements were prepared by a company not recognized by the Commission as suitable for performing audits surely would have been an important factor in an investor's decision to purchase or sell the issuers' securities. *See*

SEC v. Murphy, 626 F.2d 633, 653 (9th Cir. 1980); *SEC v. United Financial Group, Inc.*, 474 F.2d 354, 358 n. 9 (9th Cir. 1973); *SEC v. Universal Service Association*, 106 F.2d 232, 239 (7th Cir. 1939), *cert. denied*, 308 U.S. 622, 60 S. Ct. 378, 84 L. Ed. 519 (1940) (representations relating to financial condition are material); *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993); *SEC v. Texas Gulf Sulphur Co.,* 401 F.2d 833, 860-62 (2d Cir. 1968) (a person violates Section 10(b) and Rule 10b-5 by making material misstatements in, or omitting material information from, a periodic report or other filing with the Commission).

3. Respondents acted with the requisite scienter.

Hatfield and SWH knowingly, or at least recklessly, violated Exchange Act Section 10(b) and Rule 10b-5 thereunder. Hatfield, a licensed CPA since 1985 and SWH's sole proprietor, was well aware of SWH's ongoing responsibility to maintain its TSBPA license, having previously renewed the firm's license in years prior to its January 31, 2010 expiration. *See* Respondents' Answer at "Facts," ¶ 1; *see also,* Treacy Dec. at Exhibit F.

Furthermore, Respondents knew from their communications with the TSBPA that SWH's firm license would – and did in fact – expire on January 31, 2010. *See* Treacy Dec. at Exhibit C. By their own admission in documents they produced to the Commission on September 20, 2012, Respondents knew of SWH's license expiration no later than March 8, 2010, and also knew that they would be subject to TSBPA sanctions if SWH issued audit reports without a license. *See* Exhibit 1, Respondents' March 8, 2012 email from TSBPA. Hatfield nevertheless signed, and SWH issued, 38 audit reports for 21 issuers while SWH lacked a valid TSBPA license between January 31, 2010 and May 19, 2011. *See* King Dec., ¶ 11. Respondents then knowingly consented to having SWH's reports included in the Commission filings of 21 public company issuers, fully

aware that SWH was unlicensed in Texas and, therefore, was not recognized as a public accountant or certified public accountant under Regulation S-X of the federal securities laws.

4. Respondents' actions were made in connection with the purchase and sale of securities of the 21 issuers for whom they issued audit reports.

It is well-settled that Section 10(b) and Rule 10b-5 should be broadly and flexibly construed in order to effectuate their remedial purposes. *SEC v. Zandford*, 535 U.S. 813, 819-820 (U.S. 2002). To that end, "[i]n its role enforcing the [Exchange] Act, the SEC has consistently adopted a broad reading of the phrase 'in connection with the purchase or sale of any security.'" *Id.*

As detailed above, five of the 21 issuers for whom SWH issued audit reports while its license was expired had securities traded on the OTCBB. *See* King Dec. at ¶ 15. Another issuer issued securities during the same period. *Id.* at ¶ 16. By signing SWH's audit reports and consenting to their inclusion in public filings while knowing that SWH's firm license was expired, Hatfield and SWH made material misstatements in connection with the offer, purchase, and sale of these issuers' securities and thereby violated Section 10(b) and Rule 10b-5(b),[5] and should be ordered to cease and desist from violating, or causing violations, of these provisions.

C. THE COMMISSION SHOULD ORDER RESPONDENTS TO CEASE AND DESIST FROM COMMITTING OR CAUSING FURTHER VIOLATIONS OF SECTION 10(B) AND RULE 10B-5.

The Commission may impose a cease and desist order pursuant to Section 21C(a) of the Exchange Act if it finds that any person is violating, has violated, or is about to violate any rule or

[5] In *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011), the Supreme Court limited persons who may be held primarily liable for "making" a misleading statement under Section 10(b) and Rule 10b-5(b) to those "with ultimate authority over the statement, including its content and whether and how to communicate it." *Id., at* 2302. Accordingly, primary liability under Rule 10b-5(b) attaches only to the person with "ultimate authority" over the fraudulent statements. As SWH's admitted sole proprietor and the only person with authority to sign audit reports issued by SWH or to consent to their inclusion in public filings, Hatfield qualifies as a "maker" under *Janus*. *See also SEC v. KPMG LLP,* 412 F.Supp. 2d 349, 372-74 (S.D.N.Y. 2006) (concluding that the facts and circumstances indicate that the audit engagement partners, who made "ultimate decision" of whether to issue firm's audit opinion, were "makers" subject to primary liability under Section 10(b) and Rule 10b-5).

regulation. 15 U.S.C. § 78u-3(a). Whether there is some reasonable likelihood of such violations in the future must be considered. *See KPMG Peat Marwick LLP*, Admin. Pro. No. 3-9500, 2001 WL 47245 *1 (S.E.C.) (January 19, 2001).[6] When considering whether to issue a cease-and-desist order, the Commission considers "the egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that his occupation will present opportunities for future violations," collectively referred to as the "Steadman factors." *Steadman v. SEC*, 603 F. 2d 1126, 1140 (5th Cir. 1979), *aff'd. on other grounds*, 450 U.S. 91 (1981); *KPMG Peat Marwick*, 74 SEC Docket 357 (2001), *aff'd sub nom. KPMG, LLP v. SEC*, 289 F.3d 109 (D.C. Cir. 2002) (applying Steadman factors to cease and desist proceedings).

All of the *Steadman* factors weigh in favor of ordering Respondents to cease and desist from violating, or causing violations of, Section 10(b) and Rule 10b-5. Respondents' actions were clearly egregious and recurrent: they knowingly and repeatedly held SWH out as a CPA firm while its license was expired between January 31, 2010 and May 19, 2011 and during that time issued audit reports for multiple issuers they knew would be included in the issuers' Commission filings. This is not an instance of a one-time lapse in memory or an isolated, inadvertent oversight by Respondents, but rather a pattern of repeated and intentional violations of the law for which they profited.

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[6] *KPMG*, 2001 SEC LEXIS 98 , ("though "some" risk is necessary, it need not be very great to warrant issuing a cease-and-desist order. Absent evidence to the contrary, a finding of violation raises a sufficient risk of future violation.").

Additionally, Respondents acted with a high degree of scienter, having been notified numerous times by the TSBPA that SWH's license would expire, had in fact expired, and that Respondents could be sanctioned for carrying on public accountancy services with an expired license.

Furthermore, Respondents have offered no assurances against future violations or recognized the wrongful nature of their conduct; in fact, they utterly refused even to communicate with the Division during its underlying investigation, even failing to appear for testimony when properly subpoenaed. King Dec., ¶ 7.

Finally, there is a high likelihood that Respondents will continue to flout the securities laws and rules governing public accountancy because they continue to offer provide attest and other accounting services to public – and possibly non-public – companies.

For all of these reasons, and because there are no material facts in dispute, the Court should grant the Division's Motion for Summary Disposition and enter an order requiring Respondents to permanently cease and desist from violating, or causing violations of, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

D. RESPONDENTS SHOULD BE REQUIRED TO DISGORGE THEIR ILL-GOTTEN GAINS AND PAY PREJUDGMENT INTEREST PURSUANT TO SECTION 21C(E) OF THE EXCHANGE ACT.

Respondents charged a total of $187,222 in fees for audits conducted or completed while SWH's firm license was expired, the sum of which constitute ill-gotten gains as the monies were obtained as the direct result of Respondents' fraud. *See* King Dec., ¶ 18. The Division respectfully requests that this Court enter an order requiring Respondents to disgorge, jointly and severally, $187,222 as ill-gotten gains obtained in connection with their violations of the federal securities laws.

In a cease-and-desist proceeding, the Commission may enter an order requiring disgorgement of ill-gotten gains, including reasonable interest. Disgorgement is an equitable remedy that requires a violator to give up wrongfully-obtained profits causally related to the proven wrongdoing. *See SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1230-32 (D.C. Cir. 1989); *see also Hateley v. SEC*, 8 F.3d 653, 655-56 (9th Cir. 1993). Disgorgement returns the violator to where he would have been absent the violative activity. The amount of the disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation. *See Laurie Jones Canady*, Exchange Act Release No. 41250 (Apr. 5, 1999), 69 SEC Docket 1468, 1487 n.35 (*quoting SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996)), *petition for review denied*, 230 F.3d 362 (D.C. Cir. 2000); *see also SEC v. First Pac. Bancorp*, 142 F.3d 1186, 1192 n.6 (9th Cir. 1998) (holding disgorgement amount only needs to be a reasonable approximation of ill-gotten gains); *accord First City Fin. Corp.*, 890 F.2d at 1230-31.

Once the Division presumptively shows that its disgorgement figure reasonably approximates the amount of unjust enrichment, the burden shifts to Respondents to clearly demonstrate that the disgorgement figure is not a reasonable approximation. *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 1996); SEC v. Patel, 61 F.3d 137, 140 (2d. Cir. 1995; *First City*, 890 F.2d at 1232. Any risk of uncertainty as to the disgorgement amount "should fall on the wrongdoer whose illegal conduct created that uncertainty." *First City*, 890 F.2d 1232. In cases where an individual respondent's actions are inextricably interwoven with those of a business entity, joint and several liability is appropriate. *SEC v. Great Lakes*, 775 F. Supp. 211 at 214-15 (E.D. Mich.1991), *SEC v. R.J. Allen & Assocs., Inc.*, 386 F. Supp. 866, 881 (S.D. Fla. 1974).

In this case, the Division has reasonably approximated the amount Respondents should be ordered to disgorge, because it is equal to the sum they charged for audit services SWH provided

while its license was expired, as established by the issuers' disclosures of audit fees in Commission filings. *See* King Dec. at ¶ 18. Respondents have produced no evidence suggesting they collected some smaller sum for their work.

Furthermore, disgorgement of fees for audits conducted while SWH's license was expired is consistent with the Commission's prior actions requiring unregistered auditors to disgorge fees received for audit work performed in violation of Section 102(a) of the Sarbanes-Oxley Act of 2002. *See, e.g., In the Matter of Halt, Buzas & Powell, Ltd.*, Exchange Act Rel. No. 57179 (Jan. 22, 2008) (auditor who issued reports on public company financial statements while not registered with the PCAOB ordered to disgorge fees from those engagements); *In the Matter of Charles J. Birnberg, CPA*, Exchange Act Rel. No. 56405 (Sept. 13, 2007) (same).

E. RESPONDENTS SHOULD BE ORDERED TO PAY PREJUDGMENT INTEREST.

This Court may add prejudgment interest to Respondents' disgorgement amount to prevent them from benefitting from the use of their ill-gotten gains interest free. *SEC v. Blatt*, 583 F.2d 1325 (5th Cir. 1978). Whether to award prejudgment interest is a matter of discretion. *SEC v. United Energy Partners, Inc.*, 88 F. App'x 744, 747 (5th Cir.) (per curiam), *cert. denied sub nom. Quinn v. SEC*, 543 U.S. 1034 (2004); *SEC v. Gunn*, 2010 U.S. Dist. LEXIS 88164 (N.D. Tex. 2010).

When, as here, wrongdoers enjoyed access to ill-gotten funds over a period of time as a result of the wrongdoing, ordering the wrongdoer to pay prejudgment interest is consistent with the equitable purpose of the remedy of disgorgement. *See Hughes*, 917 F. Supp. at 1090. In *Hughes Capital,* the court explained its decision to require prejudgment interest as part of the disgorgement amount:

> It comports with the fundamental notions of fairness to award prejudgment interest. The defendants had the benefit of nearly $2 million dollars [sic] for the nine and one-half years

> between the fraud and today's disgorgement order. In order to deprive the defendants of their unjust enrichment, the court orders the defendants to disgorge . . . prejudgment interest.

Id.

An order for prejudgment interest against Respondents is proper in this case for the same reasons. By violating the securities laws, Respondents wrongfully obtained $187,222 and thereafter used and benefited from those funds from the time of the misappropriation to the present, offending basic principles of justice and equity.

The IRS underpayment of federal income tax rate as set forth in 26 U.S.C. § 6621(a)(2) is appropriate for calculating prejudgment interest in enforcement actions such as this. That rate of interest "reflects what it would have cost to borrow the money from the government and therefore reasonably approximates one of the benefits the defendant derived from its fraud." *First Jersey*, 101 F.3d at 1476. For Respondents, based on a principal amount of $187,222, application of the tax underpayment rate from May 19, 2011 (the date on which Respondents renewed SWH's firm license and by which they had billed for all services provided while license was expired) through January 31, 2013 results in a total prejudgment interest amount of $9,743.84. *See* King Dec. at ¶¶ 19-20. *SEC v. Razmilovic*, 2011 U.S. Dist. LEXIS 113447 (E.D.N.Y. 2011) (because defendant "had the use of [the] unlawful profits for the entire period," he was liable for prejudgment interest on the entire amount of his ill-gotten gains for the entire period from the time of his unlawful gains to the entry of judgment). Combining disgorgement and prejudgment interest, Respondents should be ordered to pay $196,965.84, jointly and severally.

F. CIVIL MONEY PENALTIES SHOULD BE LEVIED AGAINST RESPONDENTS PURSUANT TO SECTION 21B OF THE EXCHANGE ACT.

Section 21B of the Exchange Act authorizes the Commission to impose civil money penalties for willful violations of the Act or rules thereunder. In addition, Section 929P of the Dodd-Frank Act, which added monetary penalties to cease-and-desist proceedings.

In considering whether a penalty is in the public interest, the Commission may consider six factors: (1) fraud; (2) harm to others; (3) unjust enrichment; (4) previous violations; (5) deterrence; and (6) such other matters as justice may require. See Sections 21B(c) of the Exchange Act, *New Allied Dev. Corp.*, Exchange Act Release No. 37990 (Nov. 26, 1996), 52 S.E.C. 1119, 1130 n.33; *First Sec. Transfer Sys., Inc.*, 52 S.E.C. 392, 395-96 (1995); *see also Jay Houston Meadows*, Exchange Act Release No. 37156 (May 1, 1996), 52 S.E.C. at 787-88, aff'd, 119 F.3d 1219 (5th Cir. 1997); *Consol. Inv. Servs., Inc.*, 52 S.E.C. 582, 590-91 (1996).

Respondents' actions in violation of Section 10(b) and Rule 10b-5 clearly involved fraud, or at least recklessness, for which they were unjustly enriched by nearly $200,000. Further, deterrence requires substantial penalties against Respondents because they flagrantly ignored the laws governing their practice but continue to do work in the accounting and auditing field, putting other issuers and investors at risk.

The federal securities laws establish a three-tiered system of civil penalties, setting three levels of maximum monetary penalties, depending upon the gravity of the violation. The Division requests that Respondents be ordered to pay second-tier penalties, without specifying dollar amounts or units of violation. A second-tier penalty is appropriate because Respondents' violative acts involved fraud and deceit, or at least the reckless disregard of a regulatory requirement. *See* Section 21B(b)(2) of the Exchange Act. Under this provision, for each violative act or omission, the maximum third-tier penalty the Court may order is $75,000 for Hatfield and $375,000 for

SWH. *See* 15 U.S.C. 78u-2(b)(2); 17 C.F.R. § 201.1004 (Adjustment of civil money penalties). The Division does not recommend a specific penalty amount. Rather, the Division asks the Court to use its discretion to impose civil penalties in appropriate amounts against Hatfield and SWH.

G. RESPONDENTS DO NOT POSSESS THE REQUISITE QUALIFICATIONS TO REPRESENT OTHERS AND SHOULD BE PERMANENTLY DENIED THE PRIVILEGE OF APPEARING OR PRACTICING BEFORE THE COMMISSION AS ACCOUNTANTS.

Rule of Practice 102(e) is the primary tool available to the Commission to preserve the integrity of its processes and ensure the competence of the professionals who appear and practice before it. *In the Matter of Michael C. Pattison, CPA,* 2012 SEC LEXIS 2973, 15-16 (SEC 2012) (*citing Marrie v. SEC*, 374 F.3d 1196, 1200 (D.C. Cir. 2004) (stating that Rule of Practice 102(e) "is directed at protecting the integrity of the Commission's processes, as well as the confidence of the investing public in the integrity of the financial reporting process").

Section 4C(a)(1) and (3) and Rule of Practice 102(e)(1)(i) and (iii) both provide that the Commission may "censure any person, or deny, temporarily or permanently," the privilege of appearing or practicing before the Commission in any way if that person is found "not to possess the requisite qualifications to represent others" or "to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations issued thereunder."[7] Ultimately, in establishing the merits of its case, the Division is required to show that Respondents are incompetent to practice before the Commission as accountants.

Due to their knowing and repeated violations of Section 10(b) and Rule 10b-5; *i.e.,* issuing audit reports while SWH's license was expired and consenting to the inclusion of the audit reports in issuers' registration statements and periodic reports filed with the Commission,

[7] According to Rule of Practice 102(f), "practicing before the Commission" includes, but is not be limited to, "[t]ransacting any business with the Commission," and "[t]he preparation of any statement, opinion or other paper by any attorney, accountant, engineer or other professional or expert, filed with the Commission in any registration statement, notification, application, report or other document with the consent of such attorney, accountant, engineer or other professional or expert." 17 C.F.R. § 201.102(f).

Respondents lack the requisite qualifications to represent other issuers before the Commission. The Commission has previously sanctioned accountants who continued to issue audit reports even after their licenses had lapsed, concluding that they lacked the requisite qualifications to represent others. *See In the Matter of Robert W. Armstrong III*, Exchange Act Rel. No. 51920 at fn. 69 ("This reading of the Rule also conforms with past settled cases in which we have suspended accountants under Rule 102(e)(1)(iii) who either were not licensed or who had allowed their licenses to lapse at the time of their misconduct."); *see also In the Matter of Gerald M. Kudler*, Admin. File No. 3-8896 (Dec. 18, 1995) (barring, under Rule 102(e)(3), a respondent who never held a CPA license for preparing false and misleading annual and quarterly reports); *In the Matter of Stumacher*, Admin. File No. 3-9432 (Sept. 24, 1997) (barring, under subparagraphs (i) and (iii) of Rule 102(e)(1), a respondent who never held a CPA license for, among other things, falsely holding himself out as a CPA when signing audit reports).

Given the many notices provided to Respondents concerning the expiration of SWH's license, at least one of which Respondents have previously admitted, their violations can only be considered willful, knowing, and intentional. Respondents' repeated and intentional, or at least reckless, conduct demonstrates that they are incompetent and undeserving to practice before the Commission. *See U.S. v. Arthur Young & Co.*, 465 U.S. 805, 817-18 (1984) (accountant who disregards professional obligations lacks competence to discharge "'public watchdog' function'" demanding "total independence from the client at all times"). Notwithstanding their unsuitability to practice before the Commission, Respondents are currently licensed CPAs who continue to provide attest services to public – and possibly non-public – companies. They therefore pose a continuing threat to the Commission's processes and to the investing public. *See Matter of James Thomas McCurdy, CPA*, Exchange Act Rel. No. 49182, 82 SEC Docket 282, 2004 WL 210606 * 9

(Feb. 4, 2004) ("McCurdy is an actively licensed CPA, and we anticipate that he will continue to conduct audits of public companies."); *In re Marrie,* Securities Act Rel. No. 1823, Exchange Act Rel. No. 48246, 80 SEC Docket 2163, 2003 WL 21741785 * 19 & n.51 (July 29, 2003) (accountants who are "actively licensed CPAs create a significant risk that they may return to that profession and again conduct audits of public companies"). Thus, under the *Steadman* factors, discussed *infra* at § V(C), Respondents should be permanently barred from appearing before the Commission in accordance with Rule 102(e)(1)(i) and (iii).[8]

VIII.
CONCLUSION

For the foregoing reasons, the Division respectfully requests that its motion for summary disposition be granted, and that an order issue

(a) requiring Scott W. Hatfield and S.W. Hatfield, CPA to cease and desist from violating or causing violations of Section 10(b) of the Exchange Act of 1934 and Rule 10b-5 thereunder;

(b) requiring Respondents to pay $187,222 in disgorgement, jointly and severally;

(c) requiring Respondents to pay $9,743.84 in prejudgment interest, jointly and severally;

(d) requiring Scott W. Hatfield to pay a civil penalty of no more than $75,000 per violation, in an amount to be determined by the Court;

(e) requiring S.W. Hatfield CPA to pay a civil penalty of nor more than $375,000 per violation, in an amount to be determined by the Court; and

[8] Respondents cannot in good faith argue that Rule 102(e) sanctions are "punitive," as to do so would place undue emphasis on the implications for Hatfield's own career. *See Decker v. SEC*, 631 F.2d 1380, 1384 (10th Cir. 1980) (SEC disciplinary actions are "remedial in character, with the primary function of protecting the public," even though they "portend serious consequences for the individuals involved"). Indeed, if sanctions were to be viewed from a subjective perspective, every sanction could constitute a "penalty." *See Johnson v. SEC*, 87 F.3d 484, 488 (D.C. Cir. 1996) (adopting "objective" standard, since "'even remedial sanctions carry the sting of punishment'"). Thus, 102(e) sanctions, including those sought to be imposed against Respondents are remedial.

(f) permanently barring Respondents from appearing or practicing before the Commission pursuant to Rule of Practice 102(e)(1)(i) and 102(e)(1)(iii).

Dated: January 30, 2013.

Respectfully submitted,

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